

5.0 Utility Service Territory Agreements in Washington

ESSB 6560 directs the Washington Utilities and Transportation Commission (UTC) and the Department of Community, Trade and Economic Development (CTED) to study

“[t]he status, number, and primary characteristics of service territory agreements between electric utilities.”

Our examination of service territory agreements is divided into four parts:

- ❖ Brief introduction to the issues surrounding utility service territories and service territory agreements;
- ❖ Description of Washington law and background concerning utility service territories;
- ❖ Summary of the results of our survey regarding existing service territory agreements;
- ❖ Discussion of policy issues concerning utility service territories.

5.1 Introduction

Washington State is unique in that it does not have certificated distribution service territories, as do most other states. This issue of certificated service territories surfaced repeatedly during the several stakeholder meetings conducted by the WUTC and CTED. As discussed in several sections of this report, some stakeholders support the establishment of distribution service territories, arguing that such territories would serve to clarify not only the geographic boundaries within which a utility may serve, but also identify the utility having the obligation to serve the customers within those boundaries. Others oppose the establishment of distribution service territories, arguing that such territories, would serve to undermine competition. Reducing the uncertainty and risk associated with bypass may reduce the competitive pressure to keep electric service rates low.

5.1.2 Certificated Distribution Service Territories in the Gas Industry

The Legislature has established certificated distribution service territories for the gas industry. Under that statutory scheme, a utility may not provide gas service in a particular territory unless it first obtains a certificate of public convenience and necessity. These certificates are not exclusive. They do not preclude private parties from constructing and operating gas delivery facilities for their own use. Moreover, they do not preclude a utility from operating in another utility's service territory, if the incumbent utility is providing inadequate service.

5.2 Service Territory Law and Background

There is no general statute pertaining to the franchising of electric utility service territories in Washington. Entities authorized to provide electricity service in Washington include: public utility districts, cities and towns, cooperative corporations,

irrigation districts, certain port districts, and investor-owned utilities. The enabling statutes for each establish, more clearly for some than for others, the extent of utility service permitted.

For the Public Utility Districts (PUD), chapter 54.08 RCW outlines the general election process that establishes a PUD and its geographic boundaries. Essentially, a PUD's geographic boundary is coextensive with the county where the utility is formed, but an area smaller than the county can be established along voting district lines. Annexation of contiguous territory is allowed under RCW 54.04.035.

A PUD's geographic boundary, however, does not limit its potential electric service territory. RCW 54.16.040 allows a PUD to purchase and generate electricity, and to construct and operate distribution and transmission plant, both within and outside its boundaries, for the purpose of "furnishing" electricity to its inhabitants or other persons, including public and private corporations, also both within and outside its geographic limits. Therefore, while the political boundaries of a PUD are generally coextensive with the county in which it is formed, its "service territory", in theory, can extend to the entire state. However, any such extraterritorial activity must be reasonably related to the PUD's core purpose of serving its own customers. (In State ex rel. PUD No. 1 of Skagit County v. Wylie, 28 Wn.2d 113, 182 P.2d 706 (1947), the state Supreme Court rejected Skagit PUD's attempt to take over Puget's electric system in 18 counties, concluding that such an expansion went well beyond what was needed to serve the citizens of Skagit County). In order to construct utility plant inside a city or town to provide service in that city or town, a PUD must gain the consent of the city's governing body and the approval of a plan for the construction, RCW 54.04.040. We are not aware of any similar provision when a PUD decides to locate facilities in the "service territory" of an investor-owned utility.

For municipal utilities, a non-code city or town incorporated under Title 35 RCW has the authority to provide electric service both within and outside its political boundaries (RCW 35.84.010; 35.92.050). Code cities incorporated under Title 35A have similar authority to provide electric service both inside and outside their municipal boundaries, RCW 35A.80.010. The authority of code and non-code cities and towns to provide electric service includes the authority to construct and maintain all necessary facilities and to regulate the control, use, distribution and price of energy, RCW 80.04.500.

For electric cooperatives, there is no statute fixing service territory boundaries or limits at the time the cooperative corporation is formed. The cooperatives are formed under the Cooperative Associations Act, chapter 23.86 RCW, or the Mutual Cooperations Act, chapter 24.06 RCW, as entities formed to engage in any lawful business to serve the collective purposes of their members as a nonprofit cooperation, or on the cooperative plan. Service territories are presumably a function of the geographic distribution of the cooperative's members and the distribution facilities which the cooperative has built, acquired the use of, or owns to provide service to its members.

Irrigation Districts formed under chapter 87.03 RCW are authorized to own and operate electrical distribution systems for the purpose of serving the domestic uses of the district's inhabitants. Nothing in statute authorizes irrigation districts to provide service to persons other than district inhabitants. Consequently, irrigation district boundaries would appear to define the limits of the electric service territory. Currently, one irrigation district acts as an electric utility.

Port districts formed under Title 53 RCW are authorized to operate "water, light, power, and fire protection facilities" within areas established as industrial development districts, RCW 53.25.100. Industrial development districts are established to enhance the use of "marginal lands" the characteristics of which include, among other things, inadequate streets, open spaces and utilities. Ports establish the boundaries of these industrial development districts at the time they are formed and their powers appear only to be authorized within these boundaries. Consequently, electricity service provided by the Port does not extend beyond the boundaries of the industrial development district. It is unclear whether a district could provide light and power services if utility services already existed and were adequate. Currently, one port district acts as an electric utility.

Regarding private electric utilities regulated by the WUTC, there is no state statutory basis for geographic definition of service territories. The existence of electric service territories from the commission's perspective is largely one of historical development, practice, and economics, rather than any legally binding territory definition. While service territory agreements involving IOUs must be approved by the UTC (RCW 54.48.040), the Commission does not, by its approval, gain jurisdiction over a utility which it does not otherwise regulate. Cooperatives are exempt from commission jurisdiction (RCW 54.48.040), as are PUDs (RCW 54.16.040) and municipal utilities (RCW 80.04.500). Once approved, the service area agreement establishes only where the regulated utility must serve subject to UTC jurisdiction.

The Legislature addressed the issue of potential for duplication of lines and facilities given the lack of definition of service territories in chapter 54.48 RCW which allows IOUs, PUDs, coops and municipal utilities to bind each other to a division of adjoining territory through service area agreements. These are voluntary contractual arrangements of up to 25 years in duration which, if they involve an IOU, must be reviewed and approved by the UTC. By authorizing such service territory agreements, state law establishes a basis for defining distribution system boundaries, but only if the affected utilities can come to a voluntary agreement.

Historically, regulated electric companies have petitioned the UTC for approval of service territory agreements based on distinct boundaries for each utility, similar to a certificated area or franchise. However, the UTC recently approved a service territory agreement between a regulated electric company and a cooperative that establishes rules under which the parties will compete with one another today and in the future. That agreement identifies areas of future development where the parties could not agree on which utility should be given the right to serve new customers. For those areas, the agreement establishes rules to determine which

utility will serve. The agreement further designates two areas as completely open to competition. Finally, the parties agreed to allow new large-load customers to choose their service providers without regard for the agreed-on boundaries.

The state Supreme Court recently analyzed chapter 54.48 RCW. In Tanner Electric Coop. v. Puget Sound Power & Light Co., 128 Wn.2d 656, 911 P.2d 1301 (1996), the state Supreme Court considered an action by an electric cooperative (which the UTC does not regulate) against a regulated privately-owned utility for violation of a service territory agreement between the two utilities. The Court held that, pursuant to chapter 54.48 RCW, the cooperative did not have a claim against the privately-owned utility under the Consumer Protection Act, chapter 19.86 RCW.

The Tanner Court based its decision in part on its view of the extent of the powers of the UTC. The Court stated:

As we stated earlier, the WUTC is charged with administering pervasive regulatory schemes that affect almost every phase of activity of the businesses under its authority. . . . As part of this regulatory process, RCW 54.48.030 provides that the WUTC must approve all service area agreements entered into by public utilities and cooperatives.

128 Wn.2d at 682.

The Court further found that the UTC has jurisdiction not only to approve or disapprove service area agreements between private electric utilities and rural cooperatives, but also to apply and interpret relevant statutes when a dispute arises from such an agreement. Id. at 665.

5.3 Current Status of Service Territory Agreements in Washington

The WUTC and CTED developed ten survey questions concerning service territory agreements. Utilities were asked to provide the following information:

- ❖ Copies of all service territory agreements to which they are a party;
- ❖ Descriptions and dimensions of service territories;
- ❖ Dates of contract execution and expiration;
- ❖ Whether the agreement contains an option to renew;
- ❖ Whether geographic boundaries are well-delineated or subject to change;
- ❖ Whether the parties encountered disputes and, if so, how those disputes were resolved;
- ❖ Whether the agreement provides for the recovery of stranded costs.

Eighteen utilities responded to the survey. The information collected is briefly summarized below. For detail regarding individual service territory agreements the attached chart (Table 5.1) depicts the primary characteristics of the agreements.

Number of Service Territory Agreements and Coverage Area

There are 17 service territory agreements currently in effect. An additional 11 agreements have formally expired, but many of these are still being observed. The largest geographic area covered by a service territory agreement is 4,296 square miles in size. The smallest is one square mile. Of the 17 service territories, all but 4 have specific geographic boundaries.

Duration of Agreements and Current Status

The overwhelming majority of service territory agreements contain 20 to 25 year terms, the duration allowed by statute. Four of the current agreements will expire before 2005. Six of the agreements have expiration dates between 2012 and 2020. Three agreements contain provisions for automatic renewal of the agreements as they expire. All agreements may be renewed by mutual consent of the parties.

Dispute Resolution

Most service territory agreements have operated successfully without disputes between the parties. Of disputes arising out of service territory agreements, all but one were resolved short of litigation. One service territory agreement contains a provision requiring binding arbitration in the event a dispute arises.

Stranded Cost Recovery

Four service territory agreements currently in effect contain provisions regarding stranded cost recovery.

5.4 Policy Considerations

Currently, no territorial constraint is placed on any entity authorized to provide retail electric service from providing such service to any person in the state. Similarly, no territorial protection is granted to any entity acting as a utility from any other entity authorized to provide electricity service. Practically speaking, however, areas already served by the distribution facilities owned or controlled by one entity could not be served by another without a duplication of facilities, voluntary agreement to permit use of facilities, or outright purchase or condemnation of facilities. Apart from the ability to request unbundled use of another entity's transmission system under section 211 of the Federal Power Act, we are unaware of any statutory basis for an entity authorized to be a utility to demand interconnection or unbundled use of another entity's distribution or transmission facilities. So, while service territories do not technically exist by law, they do exist in practice based on the territorial extent of distribution facilities. These practical territories are, however, vulnerable, particularly in the face of physical duplication of existing facilities.

The first policy issue raised by these circumstances is that contractual service territory agreements may not serve to achieve the state's statutory policy against duplication of lines and facilities (RCW 54.48.020). The contracts only exist in circumstances where distribution utilities can reach agreement. Where utilities cannot reach agreement, there is nothing to discourage or prevent the duplication

of facilities. Even where distribution utilities can agree on contract terms, those terms may not entirely prevent the potential for wasteful duplication of facilities. Finally, increasingly competitive circumstances in the electricity industry may serve to undermine the effectiveness of voluntary contracts as a means to discourage facility duplication.

The second policy issue has to do with changes that may evolve in the nature of retail electricity service to enhance competition and expand the service options available to individual customers. Historically, all retail customers have received bundled service. Utility competition for customers existed, but on the basis of large pieces of service territory (e.g. municipalization, PUD formation). Service territory border disputes between utilities did arise periodically and some, although very few, examples of wires bypass did occur. Fundamentally, however, each utility was responsible for arranging for all of the bundled service needs of all of the consumers connected to its system and all of those consumers were responsible for compensating the utility for this service.

Proposals to restructure electricity service vary in both scope and timing, but all approaches will likely result in one utility (or other electricity provider) being able to serve at least some class of customers connected to another utility's distribution system. Such a system can work only if all customers are connected to a distribution system and these distribution systems function as a "common carrier." The extent of the utility's obligation to provide service would become a function of individual consumer choices, rather than the utility being obligated to provide like service to all customers. This obligation may vary from simply connecting the customer to the distribution network, to providing a fully bundled service. Fundamentally, the role of the distribution system and the obligations and rights of a utility and its customers would change significantly if such restructuring were to occur.

If such changes are under consideration, it may be reasonable to consider whether the efficient operation of a restructured retail electricity service industry would benefit from a change in policy concerning electricity franchises. If a distribution system franchise were established, it could follow the model of natural gas "certificates of public convenience and necessity". The UTC grants such certificates to both cities and private gas utilities, and these certificates are subject to existing laws regarding powers of consumer-owned utilities (such as forming utilities and preserving local rate setting). Such a franchise is not exclusive. Essentially, a non-exclusive franchise would function as a contract between the utility and the state. It would establish for the holder the right to provide services in the defined area. In return, it establishes the obligations of the holder (e.g., to operate a reliable and safe system, provide connection and service without undue discrimination).

Proponents of explicit franchises generally argue that they would prevent costly duplication of facilities, clarify service rights and obligations, and help distinguish between monopoly and competitive services. Opponents of explicit franchises generally argue that the threat of bypass exerts competitive pressure on utilities to keep rates low. Exclusive franchises, they suggest, would relieve this pressure and allow utilities to load unnecessary costs into rates. Non-exclusive franchises may

mitigate this problem, but by the same token, they may not prevent duplication of facilities.

Additional discussion of policy issues associated with certificated distribution service territories is included in Sections 3 and 4, since establishing such territories may affect both the costs of electric service and distribution of those costs.

Figure 5.1. Characteristics of Service Territory Agreements in Washington.

Description	Start	End	Years	Auto. Renewal	Flexible Boundary	Area Miles^2	Disputes	Dispute Process	Stranded Cost Recovery
Benton PUD/Richland City	1977	2002	25	NO	NO	N/A	YES	NO	NO
Benton PUD/Benton REA	1970	NO	N/A	YES	YES	1703	YES	Mutual	NO
Benton REA/Pacific P&L	1998	2015	17	NO	YES	4296	YES	Mutual	NO
Benton REA/Richland City	1978	2003	25	NO	NO	34	NO	Mutual	YES
Big Bend/Franklin PUD	1955	N/A	N/A	N/A	NO	435	N/A	NO	NO
Grant PUD/Inland P&L	1995	2020	25	NO	NO	12	NO	NO	YES
Grant PUD/Big Bend	1976	2001	25	NO	NO	110	NO	NO	NO
Grays Harbor/Pacific PUD	1990	N/A	N/A	N/A	YES	10	NO	N/A	YES
Grays Harbor/McCleary P&L	1965	1985	20	NO	NO	1	NO	N/A	YES
Inland P&L/WA Water Power	1998	2013	15	YES	YES	N/A	YES	YES	NO
Nespelem/Okanogan PUD	N/A	N/A	N/A	YES	NO	400	NO	NO	NO
Parkland L&W/Tacoma City	1974	1994	20	NO	NO	3	NO	NO	NO
Parkland L&W/Elmhurst	N/A	N/A	N/A	N/A	NO	N/A	NO	N/A	N/A
Parkland L&W/Lakeview L&P	N/A	N/A	N/A	N/A	NO	N/A	NO	N/A	N/A
PSE/Elmhurst	1978	2003	25	NO	NO	17	NO	NO	NO
PSE/Ohop	1987	2012	25	NO	NO	90	NO	NO	NO
PSE/Milton Town	1989	2014	25	NO	NO	2.25	NO	NO	NO
PSE/Sumas Town	1992	2017	25	NO	NO	1.25	NO	NO	NO
PSE/Tacoma City	1990	2015	25	NO	NO	100	NO	NO	NO
Tacoma City/Alder	1974	1994	20	NO	NO	10	NO	NO	NO
Tacoma City/Eatonville Town	1975	1995	20	NO	NO	1.6	NO	NO	NO
Tacoma City/Elmhurst	1974	1994	20	NO	NO	20	NO	NO	YES
Tacoma City/Fircrest City	1975	1995	20	NO	NO	1.5	NO	NO	YES
Tacoma City/Lakeview L&P	1974	1994	20	NO	NO	80	NO	NO	YES
Tacoma City/Milton Town	1974	1994	20	NO	NO	2.4	NO	NO	YES
Tacoma City/Ohop	1974	1994	20	NO	NO	80	NO	NO	YES
Tacoma City/Steilacoom Town	1977	1997	20	NO	NO	2.1	NO	NO	YES
Tanner Electric/PSE	1966	1991	25	YES	NO	N/A	YES	NO	NO